

## Message Text

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14-11

ACTION EA-10

INFO OCT-01 EUR-12 ISO-00 CIAE-00 DODE-00 PM-03 H-02

INR-07 L-03 NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15

USIA-06 AID-05 COME-00 EB-07 FRB-03 TRSE-00 XMB-02

OPIC-03 CIEP-01 LAB-04 SIL-01 OMB-01 STR-04 CEA-01

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E.O. 11652: N/A

TAGS: ECON, OECD, AS

SUBJECT: EDRC ANNUAL REVIEW OF AUSTRALIA: EMBASSY COMMENTS

REF: (A) OECD PARIS 14868; (B) CANBERRA 3795

1. WE HAVE TWO OBSERVATIONS ON SECRETARIAT'S SURVEY AS  
SUMMARIZED REF (A) : (1) WE INCLINED BELIEVE SINGLE MOST  
IMPORTANT PROBLEM OVER PAST TWO YEARS HAS BEEN WAGE EXPLOSION  
AND THAT "STOP-GO NATURE OF DOMESTIC POLICY" MENTIONED BY  
SECRETARIAT IS MORE A SYMPTOM THAN A CAUSE OF THE UNDERLYING  
PROBLEM. DURING CALENDAR 1974 AVERAGE WEEKLY EARNINGS  
INCREASED 28.6 PCT. WHILE CPI INCREASED 16.3 PCT., GDP  
DEFLATOR 18 PCT. AND MONEY SUPPLY 9.1 PCT. THIS WAGE  
SURGE CONTRIBUTED HEAVILY TO BUSINESS' LIQUIDITY SQUEEZE  
AND REDUCED LABOR DEMAND. AT SAME TIME, GOA OVER-RELIANCE

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ON MONETARY POLICY, IN COMPENSATION FOR RELUCTANCE TO

USE FISCAL POLICY, AGGRAVATED LIQUIDITY SQUEEZE. RESULTING PRESSURE ON BUSINESS, ADMITTEDLY HEIGHTENED IN CERTAIN SENSITIVE AREAS BY RAPID IMPORT INCREASES, CREATED SUDDEN UNEMPLOYMENT RISE. RESULT WAS IRRESISTIBLE POLITICAL PRESSURE FOR DOMESTIC STIMULATORY MEASURES INCLUDING IMPORT RESTRICTIONS, LIBERAL CREDIT AND CONTINUED HIGH PUBLIC EXPENDITURE.; (2) IN FOREIGN TRADE AREA SECRETARIAT MAY UNDER-ESTIMATE AUSTRALIAN 1975 EXPORT POTENTIAL. EXPORTS TO DATE HOLDING UP VERY WELL DESPITE DEPRESSED WORLD DEMAND. MAJOR AUSTRALIAN EXPORT PRODUCTS LARGELY FROM CAPITAL INTENSIVE PRIMARY INDUSTRIES IN WHICH INCREASING UNIT LABOR COSTS HAVE LESS IMPACT ON PRICE COMPETITIVENESS AND MANY OF THESE EXPORTS SOLD AT WORLD MARKET PRICES WHICH MEANS LABOR COSTS TEND TO BEAR MORE ON EXPORTERS' RETURNS THAN WORLD COMPETITIVENESS.

2. MISSION SHOULD ALSO NOTE THAT RECENT SERIES AUSTRALIAN IMPORT RESTRICTIONS MOTIVATED EXCLUSIVELY BY DOMESTIC EMPLOYMENT AND PRODUCTION CONSIDERATIONS AND NOT CONNECTED WITH ANY SHORT-RUN BALANCE OF PAYMENTS CONSIDERATIONS. AS SECRETARIAT REPORT SUGGESTS, AUSTRALIAN B/P SITUATION NOW AND PROSPECTIVELY UNLIKELY TO JUSTIFY IMPORT RESTRICTIONS, BUT IN VIEW EMPLOYMENT MOTIVATION FAVORABLE B/P OUTLOOK HAS LITTLE OR NOT RELEVANCE TO PROSPECT FOR THEIR REMOVAL.

3. RE QUESTIONS PROPOSED PARA 6 REF (A). WE AGREE SUBJECT OF WAGE INDEXATION SHOULD PROVE FRUITFUL DISCUSSION TOPIC, AND SUGGEST MISSION ALSO ASK GOA DEL TO COMMENT ON LIKELIHOOD INFLUENTIAL UNIONS WILL IN FACT BE PERSUADED TO LIMIT DEMANDS TO INDEXATION LEVEL. AS MISSION PROBABLY KNOWS, OPTION IN AUSTRALIAN SITUATION IS BETWEEN INCREASES LIMITED TO INDEXATION AND INCREASES FAR EXCEEDING INDEXATION. FEW OBSERVERS REALISTICALLY EXPECT INDEXATION TO COUNTER INFLATION. MOST OPTIMISTIC HOPE IS THAT IT WILL MINIMIZE WAGE CONTRIBUTIONS TO ADDITIONAL INFLATION. IN SAME CONNECTION, MISSION MAY WISH TO ASK GOA DEL FOR COMMENT ON TWO OTHER QUESTIONS: (1) THE PROSPECT FOR ADOPTION OF RECENT MATHEWS COMMITTEE PROPOSALS FOR INDEXATION OF INDIVIDUAL AND CORPORATE INCOME TAXES (SEE NEXT PARA); AND (2) THE PROSPECT THAT BUDGET NOW IN PREPARATION LIKELY TO LIMITED OFFICIAL USE

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SUCCEED IN MAKING SIGNIFICANT REDUCTIONS IN PUBLIC EXPENDITURE. (AS MISSION MAY KNOW, JUNE 5 CABINET RESHUFFLE REPLACED FORMER TREASURER CAIRNS WITH NEW TREASURER HAYDEN. LATTER ON RECORD THAT DEFICIT MUST BE REDUCED, GROWTH OF PUBLIC SECTOR SLOWED, AND PRIVATE SECTOR RESTORED TO HEALTH. BUT HAYDEN INHERITS BUDGET ALREADY IN PREPARATION AND IMPORTANT QUESTION IS WHETHER HE CAN PUT STAMP OF HIS VIEWS ON FINAL PRODUCT.)

4. RE MATHEWS REPORT REFERRED TO IN PREVIOUS PARA - THIS REPORT ON TAX IMPLICATIONS OF INFLATION RECOMMENDS DETAILED MEASURES WHICH WOULD ELIMINATE PROGRESSIVE IMPACT OF INFLATION ON INDIVIDUAL TAX LEVELS AS WELL AS ON CORPORATE INVENTORY VALUATION AND RESERVES FOR DEPRECIATION. RESULTANT EFFECT ON PUBLIC REVENUE, HOWEVER, WOULD FURTHER INCREASE EXCESSIVE DEFICIT ALREADY IN PROSPECT (SOME ESTIMATE \$-5 BILLION) FOR FISCAL 1976 AND CORRESPONDINGLY INCREASE THE DIFFICULT TASK OF EXPENDITURE REDUCTION ALREADY FACING THE BUDGET MAKERS.

5. MISSION MAY ALSO WISH TO INVITE GOA DEL. COMMENT ON SIGNIFICANCE OF LATEST UNEMPLOYMENT DATA. RECENT PRELIMINARY UNEMPLOYMENT RELEASE INDICATES SUBSTANTIAL REDUCTION (FROM 4.4 TO 4.1 PCT.) IN REGISTERED UNEMPLOYMENT. THIS INTERPRETED BY MANY OBSERVERS AS EVIDENCE OF TURN-AROUND IN BUSINESS ACTIVITY. ON OTHER HAND SOME GOVERNMENT STATEMENTS INDICATE THAT CHANGE IN STATISTICAL BASIS FOR THIS MONTHLY FIGURE WOULD ACCOUNT FOR REDUCTION OF EQUAL OR GREATER AMOUNT IN RESULTING TOTAL UNEMPLOYMENT FIGURE REPORTED, AND NOTE THAT SIGNIFICANCE OF APPARENT DECLINE FURTHER CLOUDED BY INCREASES IN PUBLIC EMPLOYMENT ON SPECIAL RECESSION-RELATED WORKS PROGRAM. WE BELIEVE THE QUESTION OF HOW THE GOA POLICY-MAKERS INTERPRET THESE UNEMPLOYMENT DATA BEARS IMPORTANTLY ON THE PROSPECTS FOR A VIGOROUS ANTI-INFLATION EFFORT. GIVEN THE SERIOUS POLITICAL REPERCUSSIONS OF THE RISE IN UNEMPLOYMENT, THE GOA ANTI-INFLATION DRIVE IS LIKELY TO BE SOMEWHAT GUARDED UNTIL THERE IS CONSIDERABLE CONFIDENCE THAT EMPLOYMENT AND INDUSTRIAL RECOVERY IS WELL UNDER WAY.  
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